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# In the Supreme Court of the United States

OCTOBER TERM, 1953

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No. 224

CIVIL AERONAUTICS BOARD, PETITIONER

*v.*

ARTHUR E. SUMMERFIELD, POSTMASTER GENERAL  
OF THE UNITED STATES, THE UNITED STATES OF  
AMERICA, ON BEHALF OF THE POSTMASTER GEN-  
ERAL, AND WESTERN AIR LINES, INC.

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No. 225

WESTERN AIR LINES, INC., PETITIONER

*v.*

CIVIL AERONAUTICS BOARD, ARTHUR E. SUMMER-  
FIELD, POSTMASTER GENERAL OF THE UNITED  
STATES, AND THE UNITED STATES OF AMERICA,  
ON BEHALF OF THE POSTMASTER GENERAL

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*ON WRITS OF CERTIORARI TO THE UNITED STATES COURT  
OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT*

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**BRIEF FOR THE POSTMASTER GENERAL AND THE UNITED  
STATES OF AMERICA**

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## **OPINIONS BELOW**

The opinion of the United States Court of Appeals for the District of Columbia Circuit (R. 341-353) is reported in 207 F. 2d 200. The opinions of the Civil

(1)

Aeronautics Board (R. 54-125, 183-253, 258-281, 333-339) have not yet been published.

### **JURISDICTION**

The judgment of the Court of Appeals was entered on May 4, 1953 (R. 354). The petitions for writs of certiorari were filed on July 31, 1953, and were granted on October 12, 1953. The jurisdiction of this Court is conferred by 28 U. S. C. 1254 (1).

### **QUESTIONS PRESENTED**

In fixing subsidy mail pay for a past period, the Civil Aeronautics Board refused to offset the portion (\$447,000) of the total profit (\$1,099,000) made by a carrier on the 1947 sale of one of its routes and related equipment which represented the value of the transferred certificate of public convenience and necessity. Section 406 (b) of the Civil Aeronautics Act directs the Board, in fixing mail pay subsidy, to "take into consideration \* \* \* the need of each such air carrier for compensation \* \* \* sufficient \* \* \* together with all other revenue of the air carrier, to enable such air carrier \* \* \* to maintain and continue the development \* \* \*" of a national air transportation system. The questions presented are:<sup>1</sup>

<sup>1</sup> We do not discuss the other questions raised by petitioner Western in No. 225 that the Board awarded it insufficient subsidy by erroneously offsetting certain other portions of its revenue. These issues, which the Court of Appeals decided against Western, are discussed in petitioner Board's brief, pp. 13-20. We support the position there taken that those other items of revenue properly were used to reduce the carrier's mail pay need.

1. Whether Section 406 (b) of the Act empowers the Board to award a subsidy in the form of "need" mail pay which exceeds the carrier's actual "need."

2. Whether Section 406 (b) requires the Board, in determining a carrier's "need" for subsidy, to offset "all other revenue of the air carrier," or whether the Board may, in its discretion, offset only a part of such other revenue.

3. Whether the carrier "needed" the additional \$447,000 subsidy which it received as a result of the Board's refusal to offset the profit on the sale of the certificate.

#### STATUTE INVOLVED

The Civil Aeronautics Act of 1938, 52 Stat. 973, as amended, 49 U. S. C. 401, *et seq.*, provides in pertinent part as follows:

Section 401 (h) The [Board], upon petition or complaint or upon its own initiative, after notice and hearing, may alter, amend, modify, or suspend any such certificate, in whole or in part, if the public convenience and necessity so require, or may revoke any such certificate, in whole or in part, for intentional failure to comply with any provision of this title or any order, rule, or regulation issued hereunder or any term, condition, or limitation of such certificate:  
\* \* \* [49 U. S. C. 481 (h).]

\* \* \* \* \*

Section 401 (j) No certificate shall confer any proprietary, property, or exclusive right in the use of any air space, civil airway, land-

ing area, or air-navigation facility. [49 U. S. C. 481 (j).]

\* \* \* \* \*

Section 406 (a) The [Board] is empowered and directed, upon its own initiative or upon petition of the Postmaster General or an air carrier, (1) to fix and determine from time to time, after notice and hearing, the fair and reasonable rates of compensation for the transportation of mail by aircraft, \* \* \* and the rates so fixed and determined shall be paid by the Postmaster General from appropriations for the transportation of mail by aircraft. [49 U. S. C. 486 (a).]

Section 406 (b) In fixing and determining fair and reasonable rates of compensation under this section, the [Board], considering the conditions peculiar to transportation by aircraft and to the particular air carrier or class of air carriers, may fix different rates for different air carriers or classes of air carriers, and different classes of service. In determining the rate in each case, the [Board] shall take into consideration, among other factors, the condition that such air carriers may hold and operate under certificates authorizing the carriage of mail only by providing necessary and adequate facilities and service for the transportation of mail; such standards respecting the character and quality of service to be rendered by air carriers as may be prescribed by or pursuant to law; and the need of each such air carrier for compensation for the transportation of

mail sufficient to insure the performance of such service, and, together with all other revenue of the air carrier, to enable such air carrier under honest, economical, and efficient management, to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the national defense. [49 U. S. C. 486 (b).]

#### STATEMENT

Petitioners challenge the correctness of the Court of Appeals' decision that the Civil Aeronautics Board awarded excessive mail pay subsidy to petitioner Western Air Lines ("Western"). The court held that, in determining Western's subsidy need, the Board had departed from the applicable statutory standard in failing to offset part of the profit made by Western on the sale of one of its routes to United Air Lines ("United"). A brief description of the certification and route transfer proceedings is necessary for an understanding of the case.

#### THE CERTIFICATION AND ROUTE TRANSFER PROCEEDINGS

On November 11, 1944, the Board issued a certificate of public convenience and necessity to Western for a new route (route 68) between Denver, Colorado, and Los Angeles, California. *Western Air Lines, Denver-Los Angeles Service*, 6 C. A. B. 199, affirmed *sub nom. United Air Lines v. Civil Aeronautics Board*, 155 F. 2d 169 (C. A. D. C.). The Board selected

Western over United, the principal other applicant, because award of the route to United "would divert so much traffic from Western as to seriously impair that carrier's ability to continue as a strong independent air carrier in a position to compete for traffic in the western section of the country," and would make Western "dependent upon the Government for substantial subsidies in the form of mail compensation in order to provide the service contemplated in its existing certificates." 6 C. A. B. 210. The Board concluded that maintenance of Western "as a strong regional carrier in a position to compete effectively" in its service area "outweighs any benefits which might accrue from the establishment of [the] additional single-company service from Los Angeles to the east via Denver" which United could provide. *Id.* at 212.

Western did not inaugurate service over route 68 until April 1, 1946 (R. 59). Less than a year later Western and United entered into an agreement, subject to approval by the Board, for the sale of the certificate and route, together with aircraft and equipment used thereon, to United for \$3,750,000. The purchase price represented a substantial profit to Western over the cost of the tangible property to be transferred.<sup>2</sup>

On August 25, 1947, the Board approved the sale as "consistent with the public interest." *United*

<sup>2</sup> Route 68 was the only one on which Western made a profit during 1946. During the nine months of that year when the route was in operation, it earned approximately \$640,000. 8 C. A. B. 298, 301.



*Air Lines-Western Air Lines, Acquisition of Air Carrier Property*, 8 C. A. B. 298, 324. The Board pointed out that Western's president had testified that in his view Western's "dual role" as a regional and a transcontinental carrier was "one of the primary causes" of the carrier's financial difficulties;<sup>3</sup> that Western should withdraw from the transcontinental field and "concentrate on a regional service";<sup>4</sup> and that United's routes made it the logical carrier to take over route 68 (*id.* at 303). The Board noted that the purchase price exceeded Western's depreciated original cost of the tangible property transferred by \$2,000,000, of which \$1,500,000 represented the value of the route. *Id.* at 312.<sup>5</sup> It found, however, that sale of the route at a profit would not be "adverse to the public interest" (*id.* at 324), since prohibition of certificate transfers "at a commercial profit" would eliminate the carriers' "incentive" to transfer routes to other carriers "who would be in a

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<sup>3</sup> Western had "major obligations" of several million dollars coming due in February, 1947, which, if not extended or met, "could have resulted in receivership or bankruptcy". Market conditions in January, 1947, precluded the carrying out of a previously planned financing program for the company. Western's balance sheet as of February 28, 1947, showed current assets of approximately \$3,800,000 and current liabilities in excess of \$10,000,000, 8 C. A. B. 302.

<sup>4</sup> He stated that effective development of Route 68 would have required Western to undertake full transcontinental operations at an estimated capital outlay of \$85,000,000. 8 C. A. B. at 302.

<sup>5</sup> The Board found that the \$3,750,000 purchase price was a fair one reached through arms-length bargaining. 8 C. A. B. at 314-315.

position to operate them with greater advantage to the public interest," and would "'freeze' the air pattern of the Nation to its present design \* \* \*" (*id.* at 323). But, in order to prevent "inflation of the investment rate base" and "potentially higher charges to the public," the Board required United to make an immediate charge to surplus of the \$2,000,000 item of intangibles (*id.* at 318-319).

Chairman Landis, dissenting, disapproved the transaction unless the purchase price were reduced by the \$1,500,000 representing the value of the route. He stated that the parties should not be permitted to "traffic in air certificates," since Congress had stated that there is "no private proprietary right in air transportation that can be made the subject of barter and sale—the subject of an additional claim against the public" (*id.* at 344). He added that Western "actually" would be "giving up very little" in relinquishing the \$1,500,000, since under "any theory" that sum is "profit to Western and as such is revenue under section 406 (b) of the Civil Aeronautics Act which the Board must take into consideration in fixing any need rate." "The Board," he concluded, "thus must in the last analysis charge the subsidy that Western will get and upon which it must depend with that amount, so that in the end Western's acquisition of \$1,500,000 becomes only a temporary advance against future subsidy payments" (*Id.* at 344-345).

## THE MAIL PAY PROCEEDINGS

On April 26, 1944, Western petitioned the Board to increase its mail pay (R. 15).<sup>6</sup> A temporary higher rate was fixed by the Board in April 1947 (R. 44-48). On December 31, 1948, the Board issued Tentative Findings and Conclusions (R. 54) proposing total subsidy mail pay of \$4,252,000 for the period May 1, 1944, to December 31, 1948, together with an order to show cause why the proposed mail pay award should not be made final (R. 124-125).<sup>7</sup> In calculating this subsidy, the Board treated the entire profit from the sale of route 68 as "other revenue of the air carrier" which, under Section 406 (b) of the Act, would "serve to reduce Western's 'need' for mail compensation" (R. 68), and accordingly offset the total profit in ascertaining the carrier's need.

1. *The Board's First Decision.*—After full administrative proceedings,<sup>8</sup> the Board issued its first decision (R. 183-253). The Board again held that Western's entire net profit on the sale—which it calculated at \$1,099,000 (R. 196)<sup>9</sup>—constituted

<sup>6</sup> Western was then on a so-called service or compensatory rate, which the Board had fixed in November 1943. *Western Air Lines, Mail Rates*, 4 C. A. B. 441.

<sup>7</sup> The Board also proposed a prospective mail pay rate to become effective January 1, 1949 (R. 91-104). This rate became final on May 6, 1949. *Western Air Lines, Mail Rates*, 10 C. A. B. 285.

<sup>8</sup> Exceptions were filed to the tentative findings (R. 127), hearings were held, briefs were filed, and the Board heard oral argument (R. 185).

<sup>9</sup> Western's book profit of \$2,124,000 was reduced by a number of offsets against such profit (R. 70, 82, 196-197, 212-220, 264).

"other revenue" which should be offset in determining Western's need for mail pay subsidy. The Board stated that it was "clear that to the extent that there was a profit [on the sale], Western's need for mail pay support was reduced accordingly" (R. 195). Pointing out that the profit arose from the sale of "air carrier property," the Board refused to differentiate between the tangible and the intangible elements of the sale. It stated that these elements "go together to make up one transaction"; that the profit from the intangibles was no "less valid" a source of other revenue than that from the tangibles, since both were received "by virtue of benefits accruing to Western from its certificate of public convenience and necessity, which it received from the Government"; that it would be "contrary to the public interest" to use public funds to "subsidize a need which had already been covered by profits accruing from benefits under the certificate"; and that offsetting the profit on the sale of the intangibles "in no sense" curtailed the carrier's rights under its certificate, which include the right to subsidy mail pay "based upon need," but merely offset against these rights "all special benefits in the form of profits realized by virtue of having been awarded the certificate" (R. 197-198).

The Board specifically rejected Western's contention that inclusion of the total profit as "other revenue" would "adversely affect the incentive for air carriers to accomplish necessary route adjust-

ments through voluntary route transfers and mergers or consolidations" (R. 198). The Board pointed out that

The incentive of a carrier wishing to dispose of a route or to merge is to correct a situation which is inimical to its best interests, such as the operation of an uneconomical route that will mitigate against its over [ever] reaching self-sufficiency. The incentive to divest itself of such a route should be reinforced by the realization that *subsidy mail pay will not be forthcoming to perpetuate an uneconomic route pattern* [*ibid.*, emphasis added].

The Board further noted that the record did not indicate that Western would not have sold the route had it known that the profit would be treated as "other revenue" for subsidy purposes (R. 198-199); that Western had "no basis for believing otherwise" (R. 199); and that the fact that the "outstanding example" of an airline merger since the sale—the purchase of American Overseas Airlines, Inc. by Pan American Airways, Inc.—had been consummated at book value indicated that the "profit motive" is not such a "necessary consideration for the accomplishment of route transfers or mergers as Western would have us believe" (*ibid.*)<sup>10</sup>.

The Board accordingly offset Western's entire profit of \$1,099,000 in calculating that the carrier's

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<sup>10</sup> The Board pointed out that in approving the sale of route 68 it had not been "concerned with the issue of the treatment of any profit realized by Western in relation to its need for mail pay" (R. 196; see R. 262).

break-even need was \$2,087,000 (R. 229).<sup>11</sup> To this the Board added \$134,686 representing the carrier's estimated tax liability, and \$1,358,840 representing a 7% return for each of the years involved on the carrier's adjusted investment base <sup>12</sup> (*ibid.*). Total subsidy mail pay was thus fixed at \$3,580,526, or \$671,474 less than the \$4,252,000 temporary mail pay that Western already had received (*ibid.*).

2. *The Board's Second Decision.*—Exceptions to the Board's decision were filed by the Postmaster General and by the carrier (R. 254-257), and the Board heard oral argument (R. 258).<sup>13</sup> The Board's decision on the exceptions (R. 258-281) reversed its prior holding, and refused to offset the \$447,000 profit (R. 264) on the sale of the route in fixing Western's subsidy.<sup>14</sup>

<sup>11</sup> The Board also offset other non-flight revenue, including restaurant and concession income (R. 191-195). And, in determining Western's break-even point, the Board disallowed certain expenses which did not meet the statutory standard of "honest, economical, and efficient management." Thus, excessive maintenance costs were reduced (R. 207), excess general and administrative expenses were scaled down (R. 212), and depreciation on unneeded aircraft was disallowed (R. 223).

<sup>12</sup> In determining Western's investment base, the Board excluded certain items—such as excess aircraft—which did not reflect "economical and efficient management" (R. 247).

<sup>13</sup> The Air Transport Association of America, a trade association of air carriers, filed a brief *amicus curiae* supporting, *inter alia*, Western's contention that the profit from the sale of the route was not "other revenue" (R. 258-259).

<sup>14</sup> In its second decision the Board for the first time referred to its prior decision as a "tentative" one (R. 258). In its first decision the Board had stated that the matter was then before it "for our decision" (R. 185).

The Board reaffirmed its prior holding that the entire profit on the transaction—tangibles as well as intangibles—constituted “other revenue” within Section 406 (b) (R. 261).<sup>15</sup> However, the Board distinguished between the two elements, and held that it was “appropriate” to allow Western to “keep the net profit from the sale of the intangibles” (R. 264).

The Board reasoned that the statutory requirement that it “take into consideration” the “need” of the carrier, together with all its other revenue, did not require it to reduce the carrier’s mail pay “need” with any part of such other revenue; that this was a matter for its discretion; and that it might “take in” such other revenue “in whole, in part, or not at all” (R. 262). The Board stated that it had approved the sale of route 68 at a profit “because it would provide the necessary incentive for Western to dispose of the properties to another carrier which was in a position to operate them with greater advantage”; that it was the Board’s “serious concern” in so doing that unless Western were allowed a “commercial profit,” the Board would be “thwarting the improvement of the air pattern through voluntary action by the carriers” (R. 262–263); that if the Board were to

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<sup>15</sup> The Board stated that it could see “no distinction \* \* \* between the net revenues derived from the sale of tangibles such as operating property and equipment, and the net revenues received from the intangible elements of the sale such as the earning power of the route. Both kinds of revenue originated in the same transaction and augmented the carrier’s net income. Both must be considered in relation to the carrier’s ‘need’ ” (R. 261).

"safeguard the incentive for voluntary route transfers," it could not refuse Western the right "to retain at least some portion" of the profit (R. 264); and that, although the tangible and intangible elements together "made up the single transaction," they could be separated to determine "whether, and to what extent," the other revenue should be offset against Western's "need" (*ibid.*).

The effect of the Board's ruling on this issue was to increase Western's subsidy by \$447,000 over the amount allowed in the first decision.<sup>16</sup>

#### THE DECISION OF THE COURT OF APPEALS

On the Postmaster General's petition to review, the Court of Appeals unanimously held that the Board had erred in failing to offset the \$447,000 profit on the sale of the route.<sup>17</sup> The court pointed out that the Board had not found that "Western itself" needed the additional \$447,000 subsidy, but only that the additional amount was given "in order to encourage

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<sup>16</sup> The Board, after making further adjustments in the carrier's expenditures and tax allowance (R. 333-337), awarded Western total subsidy mail pay of \$3,917,361 (R. 337). Since Western previously had received temporary mail pay of \$4,252,000, the carrier was found to have received an overpayment of \$334,639 (*ibid.*).

The Postmaster General's petition for reconsideration, which challenged the refusal to offset the \$447,000, was denied by the Board without discussion of the issue (R. 333, 337).

<sup>17</sup> The carrier filed a separate petition to review, alleging that the Board had awarded it insufficient subsidy. The court rejected the carrier's contentions (R. 345-348, 350-351) See *supra*, p. 2, n. 1.



other carriers (not Western) to follow a given course of action" (R. 348-349). The court held that the Act does not authorize the Board "to provide incentives to the industry generally" for the development of air transportation, but restricts subsidy payments "to the need of each individual carrier to maintain and continue a development program of its own" (R. 349-350).

The court stated that it was erroneous to speak of "offset[ing]," "deduct[ing]," or "recaptur[ing]" profit by including it in revenue, since the need contemplated by the Act was a "net figure" which appears "necessary over and above that which the carrier has," and not a gross figure from which offsets or reductions were made (R. 351). The court added that (R. 351-352):

\* \* \* the passenger revenue, etc., is not "offset" against or "deducted" from the need of the carrier. None of the earned revenue is recaptured. The bare, uncomplicated situation is that when the carrier has substantial revenues from non-mail sources the margin of its need for mail pay is less.

#### SUMMARY OF ARGUMENT

Our statutory arguments under Points I and II are fully set forth in our brief in Nos. 222 and 223, this Term, and are merely summarized here.

I. Mail pay is fixed by the Civil Aeronautics Board either on a "service" rate, which constitutes fair compensation for carrying the mail, or on a "need" rate, which is an outright subsidy to enable

the carrier to earn a stated return on its investment. Section 406 (b) of the Act imposes a clear duty on the Board to limit subsidy to such amount as will meet the carrier's need as therein defined. In the instant case, the carrier received subsidy designed to give it an ample 7 percent return after taxes.

II. The Board declined to offset Western's profit on the sale of the route—admittedly “other revenue” of the carrier—on the theory that the Act gives it “discretion” to “take in ‘other revenue’ in whole, in part, or not at all.” The Act, however, requires the Board to offset *all* of the carrier's other revenue, and the Board has no discretion to offset only some of it. Western's profit from the sale of the route reduced its need for subsidy from the public treasury just as much as the profits from the sale of equipment used on that route, or from restaurant and slot machine concessions. By failing to offset the profit on the certificate, the Board gave Western \$447,000 more subsidy than it needed.

III. There is no issue here as to Western's right to “retain” any portion of the profits on the sale of the route. Western retains every penny of that profit. The only issue is how much additional money Western is to receive as a subsidy from the public treasury.

The extra subsidy was not needed to induce Western itself to sell the route. Indeed, the Board's decision makes it clear that Western was given the additional subsidy in order to encourage other carriers to effect route transfers. The Act, however,

makes the need of the individual air carrier the basis for subsidy, and does not authorize the Board to award subsidy to provide incentives to the industry generally.

There is no basis for the Board's only justification for its refusal to offset, that other carriers would refrain from making route adjustments if profits on such transfers were not to be duplicated with subsidy. The Board has adequate authority to encourage route transfers through its other powers under the Act. Retention of a route not economically adapted to the carrier's operations constitutes a failure of "economical and efficient management" which should result in reduction of subsidy. Needed changes in the route pattern can also be effected by the Board through its power under Section 401 (h) of the Act to "alter, amend, modify, or suspend" any certificate, in whole or in part. Moreover, mergers and consolidations can accomplish route alterations.

#### ARGUMENT

##### INTRODUCTION

In setting aside the Board's order, the Court of Appeals held that the Board had erred in awarding Western an additional \$447,000 subsidy "in order to encourage other carriers (not Western) to follow a given course of action" (R. 348-349). The Court stated that the Act does not authorize the Board "to provide incentives to the industry generally" for the development of air transportation, but restricts subsidy payments "to the need of each individual

carrier to maintain and continue a development program of its own" (R. 349-350). While we believe that the court was correct in this conclusion, we do not rely solely on this basis to support the decision below, but also rest on the broader ground that under the Act the Board cannot award subsidy in excess of a carrier's need, and that in determining such need the Board is required to offset *all*—and not just a part—of the carrier's other revenue. Thus, even if the Board were correct in its contention (Br. 26-27) that the incentive in this case was for Western itself, and not for the industry generally—which we dispute (see *infra*, pp. 23-26)—that fact would not validate its refusal to offset the \$447,000.

These same general statutory questions as to the Board's duty to offset all other revenue also are involved in Nos. 222 and 223, which have been consolidated with the instant case for argument. We have fully set forth our arguments on those issues in our brief in that case, and will not repeat them at length here. In sections I and II of this brief we will merely summarize our position, and refer the Court to the portions of our brief in Nos. 222 and 223 which discuss those issues in detail.

#### I.

#### SUBSIDIES IN THE FORM OF MAIL PAY CANNOT EXCEED THE "NEED" OF THE CARRIER

Section 406 (b) of the Civil Aeronautics Act requires the Board, in fixing "fair and reasonable" rates of compensation for the transportation of mail by aircraft, to "take into consideration," *inter alia*,

\* \* \* the need of each such air carrier for compensation for the transportation of mail sufficient to insure the performance of such service, and, together with all other revenue of the air carrier, to enable such air carrier under honest, economical, and efficient management, to maintain and continue the development of air transportation to the extent and of the character and quality required for the commerce of the United States, the Postal Service, and the national defense.

In fixing mail pay, the Board has recognized the distinction which the Act thus makes between compensation sufficient (1) to insure the transportation of mail, and (2) to enable the carrier "to maintain and continue the development" of a national air transportation system. Mail pay for economically self-sufficient carriers is fixed on a so-called "service rate." This constitutes fair compensation for carrying the mail, is based on mail miles flown, actual or prospective, and supposedly contains no element of subsidy. If, on the other hand, the carrier is not operating profitably, then it is given what the Board calls a "need rate." This bears no relation to carriage of mail at all, but is an outright subsidy designed to enable the carrier to meet its expenses, pay its taxes, and earn a stated return on its recognized investment base. (Brief, Nos. 222 and 223, pp. 17-18.) Western received "need" mail pay in the instant case designed to give it the 7 percent return after taxes which the Board customarily allows for past periods (R. 226).

Section 406 (b) imposes a clear duty on the Board to limit subsidy to such amount as will meet the carrier's "need" as defined in that section. Although "need" is not the only factor which the Act requires the Board to consider, it plainly is a limiting one, *i. e.*, the Board cannot award subsidy in excess of what the carrier actually needs. Congress could hardly have intended, after providing the "carefully worded 'need' formula which the Act sets for the Board's guidance in fixing the air mail 'compensation'," *American Airlines, Mail Rates*, 3 C. A. B. 323, 335, to permit the Board to disregard this standard by determining and "considering" such need, and then awarding a subsidy in excess thereof. Plainly, the Act sets the carrier's "need" as the ceiling on subsidy mail payments. See Brief, Nos. 222 and 223, pp. 16-22.

## II.

SECTION 406 (B) REQUIRES THE BOARD, IN DETERMINING A CARRIER'S SUBSIDY NEED, TO OFFSET ALL—NOT JUST SOME—OTHER REVENUE OF THE CARRIER

In fixing Western's mail pay subsidy, the Board in its initial decision first determined the carrier's break-even need by calculating the difference between the carrier's nonmail revenues and total allowable expenses.<sup>18</sup> These nonmail revenues included restaurant and concession income (R. 191-195) and the entire profit on the sale of route 68 (R. 195-200), as well as flight income. In holding that the restaurant

<sup>18</sup> The Board disallowed certain expenses which did not meet the statutory standard of "honest, economical, and efficient management" (see *supra*, p. 12, n. 11).

and concession income was "other revenue" for determining mail pay need (R. 191), the Board relied upon the "broad statutory language referring to *all* other revenues," and the "desirability of reducing government support where the carrier has net income available to it from other sources to support its certificated operations \* \* \*" (R. 193, italics in original). And, in holding that the entire profit on the sale of route 68 should be offset, the Board stated that it "would be contrary to the public interest to use public funds to subsidize a need which had already been covered by profits accruing from benefits under the certificate" (R. 198).

In its second decision, the Board again held that the entire profit on the sale of route 68 was "other revenue" within Section 406(b) (R. 261). However, the Board for the first time distinguished between the profit on the tangibles (equipment) and the intangibles (certificate), holding that the former but not the latter should be offset in calculating break-even need. It did so on the novel theory that Section 406(b) gives the Board "discretion" to "take in 'other revenue' in whole, in part, or not at all" (R. 262). We submit that this construction of the Act is unwarranted, and that under the Act the Board is required to include *all* other revenue, and has no discretion to take it in "in whole, in part, or not at all."

Section 406(b) defines the carrier's need for subsidy as an amount which, "together with all other revenue of the air carrier," is sufficient to enable the carrier

to meet the statutory objectives. In other words, the Board is directed to award subsidy in an amount which, when added to all the carrier's other, *i. e.*, non-mail pay, revenue, will provide it with funds to enable it to "maintain and continue the development of air transportation." The "bare uncomplicated situation is," as the Court of Appeals stated, "that when the carrier has substantial revenues from non-mail sources the margin of its need for mail pay is less" (R. 351-352). It was this "desirability of reducing government support where the carrier has net income available to it from other sources" that presumably led Congress to require the Board to offset *all* other revenue in determining subsidy need.

The source of such other revenue is immaterial; the significant fact is its amount. Western's need for subsidy was not increased because a portion of its revenues in 1947 was derived from the sale of a Government franchise. This revenue reduced the carrier's need for subsidy from the public treasure just as much as the revenue from the sale of the equipment used in operating under such franchise,<sup>19</sup>

<sup>19</sup> In its second decision the Board, in offsetting the profit on the tangibles, stated that it saw no reason "why the carrier's need should be duplicated" therewith (R. 264). The Board consistently has offset profits on the sale of aircraft and equipment to reduce a carrier's subsidy need. *Chicago and Southern Air Lines, Mail Rates*, 3 C. A. B. 161, 172 (1941); *Colonial Airlines, Mail Rates*, 4 C. A. B. 71, 77 (1942); *Continental Air Lines, Mail Rates*, 8 C. A. B. 825, 843 (1947); *American Overseas Airlines, Mail Rates*, 9 C. A. B. 695, 706 (1948). In *Delta Air Lines, Mail Rates*, 9 C. A. B. 645, 654 (1948), the Board offset net income derived from an insurance settlement of the crash of one of the carrier's aircraft.



or from the operations of airport restaurant and slot machine concessions. When Congress used the words "all other revenue" in Section 406 (b), it did not mean "all or some part of such other revenue." (Brief in Nos. 222 and 223, pp. 30-45.)

The result of permitting the Board to ignore portions of a carrier's other revenue—for whatever reason—is to give the carrier a subsidy in excess of its needs. In the instant case the Board's holding in its first decision, not modified in its second decision (R. 268), was that Western "needed" subsidy which, together with *all* its other revenue, *i. e.*, the entire profit on the sale of route 68, would give it a 7 percent return for the years 1944 through 1948, and the Board awarded subsidy on that basis. By subsequently refusing to offset the profit on the intangibles, the Board in effect gave the carrier an additional subsidy of \$447,000. This results in a return of 14.76 percent for 1947, the year in which Western received the profit on the sale of route 68. The Board, however, had already determined that Western needed only a 7 percent return in that year. By thus giving Western a subsidy \$447,000 greater than it needed, the Board departed from the statutory requirement (see Point I, *supra*) that, subsidy cannot exceed the need of the carrier.

### III.

WESTERN DID NOT "NEED" THE \$447,000 ADDITIONAL SUBSIDY MAIL PAY, AND THE AWARD THEREOF WAS NOT MADE ON THE BASIS OF WESTERN'S NEED

In refusing to offset the profit on the sale of the certificate, the Board did not find that Western

"needed" an additional subsidy of \$447,000, or that it "needed" a return of 14.76 percent in 1947 (see *supra*, p. 23). On the contrary, the Board merely stated that "\* \* \* if we are to safeguard the incentive for voluntary route transfers, we cannot now refuse Western the right to retain at least some portion of the net profit from the sale of Route No. 68" (R. 264). But the Board's policy of encouraging voluntary route transfers does not establish the "need" of the transferring carrier to receive extra subsidy, and it is clear that Western did not need the additional subsidy awarded in this case.

In the first place, the Board's theory is predicated on an erroneous assumption. There is no question here as to Western's right to "retain" any portion of the proceeds of the sale of route 68.<sup>20</sup> As the Court of Appeals recognized, under a subsidy system "[n]one of the [carrier's] earned revenue is recaptured" (R. 351). Contrary to the Board's suggestion (R. 263), Western "keeps" every penny of the \$3,750,000 it received from the sale of route 68, including the \$1,099,000 profit. The sole question here is how

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<sup>20</sup> The correctness of the Board's permitting Western to sell its certificate at a profit is questionable. Section 401(j) of the Act, which provides that no certificate shall confer any "proprietary" or "property" right on the holder, seemingly precludes such trafficking in certificates. Notes, 48 Columbia Law Review 88(1948), 61 Harvard Law Review 523 (1948); see dissent of Chairman Landis in the route transfer case, 8 C. A. B. at 333-334, 341-345.

much *additional* money Western is to receive as a subsidy from the public treasury. Or, putting it differently, the question is whether the Government is to duplicate through subsidy a portion of the profit previously realized by the carrier on the sale of its government franchise.

There is no showing that the extra subsidy was necessary to induce Western to make the transfer of route 68. Indeed, in its first decision the Board flatly found that (R. 198-199)—

There is no indication in the record that had Western been certain that the profit it would realize on the sale would be considered "other revenue" it would not have sold the route. In fact, it had no basis for believing otherwise when it negotiated the sale.

That finding has not been repudiated, and clearly is correct. As the Board itself recognized in its decision in the route transfer case (8 C. A. B. at 302-303) and concedes before this Court (Petition for Writ of Certiorari, No. 224, p. 11), it was Western's critical financial situation and its desire to dispose of a route not adapted to its long-term development as a regional carrier which prompted the sale. Moreover, Western could hardly have anticipated that the Board would exclude the profit from consideration for mail pay purposes. The clear warning in Chairman Landis' dissent in the transfer case that the transfer profit would reduce need mail pay

went unanswered in the majority opinion.<sup>21</sup> The only Board decision that had dealt with the question up to that time included profits on the sale of a route in determining the carrier's need. *Inland Air Lines, Mail Rates*, 1 C. A. A. 155, 162-163 (1939). Thus it cannot fairly be said that Western "needed" this extra subsidy even in the special sense that, without it, the carrier would not have sold the route.

Nor is exclusion of such profits justified as a means of encouraging route transfers generally. For, as the Court of Appeals correctly held, the Act does not authorize the Board "to provide incentives to the industry generally," but restricts subsidy payments "to the need of each individual carrier to maintain and continue a development program of its own" (R. 349-350). And it is clear that the Board awarded Western additional subsidy "in order to encourage other carriers (not Western)" to effect route transfers.

In its second decision, the Board (R. 265)—

emphasized that our decision not to include the net profit from the sale of intangibles was reached *solely* because we are thus seeking to encourage improvement of the air route pat-

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<sup>21</sup>Chairman Landis pointed out in his dissenting opinion that "under any theory" the \$1,500,000 was "revenue under section 406(b) of the Civil Aeronautics Act which the Board must take into consideration in fixing any need rate. The Board thus must in the last analysis charge the subsidy that Western will get and upon which it must depend with that amount, so that in the end Western's acquisition of \$1,500,000 becomes only a temporary advance against future subsidy payments." 8 C. A. B. 344-345.

tern through voluntary route transfers by other air carriers [emphasis added].

The Board also stated that it had permitted Western a "commercial profit" in selling route 68 to prevent "thwarting the improvement of the air pattern through voluntary action by the carriers," and that the incentive of profit from a route sale should be "preserved here" in order "to continue to encourage voluntary action by the carriers" (R. 263). In other words, the Board gave Western additional subsidy of \$447,000 in order to preserve the incentive for other carriers to sell their routes at some future date.<sup>22</sup> The Act, however, makes the "need of each such air carrier" (emphasis added) the basis for awarding subsidy. Plainly, Western cannot be said to have needed the additional subsidy because other carriers might otherwise be discouraged from effecting future route transfers.

Furthermore, there is no basis for the Board's assumption that other carriers would refrain from making route adjustments if profits on such transfers were not to be duplicated with additional subsidy. As the Board noted in its first opinion (R. 199), the only major airline acquisition during the period 1947-1951—the purchase of American Overseas Airlines by Pan American Airways—was consummated on the basis of approximate book value, and raised no issue as to profit on intangibles. *North Atlantic*

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<sup>22</sup> Indeed, the Board recognized in its second decision that in approving the sale of route 68 it had not been "concerned \* \* \* with the ultimate treatment of the profit which was to be realized by Western \* \* \*" (R. 262; see R. 196).

*Route Transfer Case*, 11 C. A. B. 676, petitions to review dismissed for want of jurisdiction, *sub nom. Trans World Airlines v. Civil Aeronautics Board*, 184 F. 2d 66 (C. A. 2), certiorari denied, 340 U. S. 941. This fact, the Board stated, indicated that "there were sufficient incentives to negotiate this transaction on the part of both parties which outweighed the consideration of a profit," and that "the profit motive is [not] such a necessary consideration for the accomplishment of route transfers or mergers as Western would have us believe" (R. 199).<sup>23</sup>

The Board has adequate authority to encourage route transfers through its other powers under the Act without having to resort to subsidies from the public treasury to accomplish this end. The Act requires carriers claiming subsidy to meet the standard of "honest, economical and efficient management." Retention of a route not economically adapted to the carrier's operations constitutes a failure of "economical and efficient management" just as much as operation of an excessive number of

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<sup>23</sup> Whatever significance the granting of additional subsidy once may have had as a means of encouraging route transfers, it appears to be of diminishing importance today. For more and more of the major domestic carriers have, as they achieved economic self-sufficiency, shifted from a need to a service basis. Civil Aeronautics Board, *Administrative Separation of Subsidy from Total Mail Payments to United States Air Carriers*, September 1953 Revision, p. 3. Subsidy, of course, can be used to encourage route transfers only as long as the carrier is on a need rate.

flights,<sup>24</sup> payment of excessive salaries,<sup>25</sup> retention of unnecessary aircraft,<sup>26</sup> or unduly high maintenance charges,<sup>27</sup> The Board has reduced subsidy payments to take account of the foregoing management inefficiencies. There is no reason why similar adjustments in subsidy mail pay cannot and should not be made with respect to uneconomical routes that a carrier refuses to relinquish. Since Western had taken the position in the route transfer case that it no longer could operate Route 68 effectively unless it went into the trans-continental field and acquired substantial additional equipment which it then was not in a position to acquire, retention of the route under those circumstances would itself have constituted a failure of "economical and efficient" management.

We think the complete answer was given by the Board itself in its first decision. In reply to Western's argument that inclusion of the profit as "other revenue" would adversely affect carriers' incentives voluntarily to adjust route patterns, the Board stated:

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<sup>24</sup> *Capital Airlines, Mail Rates*, 10 C. A. B. 705, 708-712.

<sup>25</sup> *Pioneer Air Lines, Mail Rates*, 8 C. A. B. 175, 185; *Trans-Texas Airways, Mail Rates*, 12 C. A. B. 101, 110.

<sup>26</sup> In the instant case, Western "moved quickly" to reduce the size of its fleet of DC-4 aircraft following a "rapid drop in traffic volume" in the fall and winter of 1946-1947 (R. 63-64).

<sup>27</sup> *Northeast Airlines, Mail Rates*, 9 C. A. B. 291, 296-304. In the instant case the Board disallowed certain excessive maintenance expenditures by Western (R. 212).

The incentive of a carrier wishing to dispose of a route or to merge is to correct a situation which is inimical to its best interests, such as the operation of an uneconomical route that will mitigate against its over reaching self-sufficiency. The incentive to divest itself of such a [uneconomical] route should be reinforced by the realization that *subsidy mail pay will not be forthcoming to perpetuate an uneconomic route pattern* [R. 198, emphasis added].

Indeed, the Board's settled policy to "reduce the extent of their [carriers'] dependence upon compensation from the Government,"<sup>28</sup> which the Board reasserted in its first decision (R. 193), requires such a result.

The Board also can effect desirable changes in the route pattern through its power under Section 401 (h) (*supra*, p. 3) to "alter, amend, modify, or suspend" any certificate, in whole or in part, "if the public convenience and necessity so require." Pursuant thereto the Board recently suspended the authority of two trunkline carriers to serve particular points authorized under their certificates in order to allow local carriers to serve the same places. *Western Air Lines v. Civil Aeronautics Board*, 196 F. 2d 933 (C. A. 9), certiorari denied, 344 U. S. 875; *United Air Lines v. Civil Aeronautics Board*, 198 F. 2d 100

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<sup>28</sup> *Pan American-Grace Airways, Mail Rates*, 3 C. A. B. 550, 589 (1942).



(C. A. 7). Furthermore, appropriate mergers and consolidations, which the Board has not hesitated to suggest in the past,<sup>29</sup> afford another method of accomplishing route alterations without any drain on the public purse.

We submit that the Board had no basis, evidentiary or otherwise, for a conclusion that Western needed the additional subsidy of \$447,000. In its first opinion the Board clearly recognized that fact. But in the second opinion the Board shifted from the statutory test of need to the erroneous policy concept that having allowed Western a "commercial profit" in the route transfer case, it should permit the carrier to "retain" some of such profit. The Act, however, requires that *all* other revenue be taken into account in determining need, and confers no discretion upon the Board to offset such other revenue "in whole, in part, or not at all" (R. 262). In awarding Western an additional \$447,000 subsidy to encourage changes in the route pattern, the Board exceeded its statutory authority.

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<sup>29</sup> See the Board's show cause order suggesting the combination of Continental Air Lines and Mid-Continent Airlines. Order No. E-5803, Docket No. 5173, October 23, 1951. The proceeding was dismissed following the proposed voluntary merger of Mid-Continent and Braniff Airways. Order E-6107.

A recent comment suggests a possible merger program for the airlines. 60 Yale L. J. 1196, 1213-1217 (1951).

## CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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